(5)

No. 91-615

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ALLIED-SIGNAL INC.
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

AMY EISENSTADT *
Tax Counsel
JAMES F. BURESH
Chair, Lawyers Coordinating
Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W., Suite 330
Washington, D.C. 20001
(202) 484-8103

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

13

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-615

ALLIED-SIGNAL INC.
as successor-in-interest to
The Bendix Corporation,
Petitioner,
v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a nonprofit association, which was separately incorporated on January 1, 1992. COST was originally organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST's membership consists of 365 major multistate corporations. COST member companies

conduct a substantial portion of the interstate commerce of United States taxpayers and are representative of that part of the nation's business sector which is directly affected by state taxation of interstate operations.

COST's objectives include the preservation and promotion of equitable and nondiscriminatory methods of state taxation of multistate businesses and the promotion of proper methods of assigning values, income and taxable incidents among the states. The decision of the New Jersey Supreme Court clearly impinges on these goals.

Under the decision of the New Jersey Supreme Court, the Due Process restraints on the states' power to tax investment income of nondomiciliary corporations have been eviscerated. Every COST member corporation has passive investment income which is unrelated to its business activity outside of its domiciliary state. Therefore, COST has a vital interest in this case.

SUMMARY OF ARGUMENT

This Court has set forth the limits required by the Due Process Clause on a state's power to impose its income tax on intangible investment income of a nondomiciliary corporation. First, the Due Process Clause prohibits a state from taxing value earned outside its borders. *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315 (1982). Out-of-state income may, however, be included in income subject to state apportionment if it arises from a unitary business. *Bass, Ratcliff & Gretton, Limited v. State Tax Commission*, 266 U.S. 271, 282 (1924). The "unitary business principle" is "the linchpin of apportionability in the field of income taxation". *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980). Most important to the instant case, in *ASARCO*, *supra* and *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982), this Court specifically addressed the taxation of intangible investment income and

rejected a definition of a unitary business that focused on the internal potential economic and business advantages to the taxpayer from its investments in other corporations. Rather, this Court held that dividends, interest and capital gains received by nondomiciliary corporations could not be taxed where the income was derived from "discrete business enterprises", *Woolworth*, 458 U.S. at 372, which in "any business or economic sense" had "nothing to do with the activities" of the corporations in the taxing state. *ASARCO*, 458 U.S. at 328. Thus, as framed by this Court, the issue in determining whether intangible income such as dividends, interest and capital gain income is subject to appointment is whether a unitary relationship exists between the nondomiciliary taxpayer and entities from which the intangible income was derived.

This Court reaffirmed its decisions in *ASARCO* and *Woolworth* in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), noting that "[t]he legal principles defining the constitutional limits on the unitary business principle are now well established." 463 U.S. at 176. This Court further stated

> [T]he principles we have quoted require that the out-of-State activities of the purported "unitary business" be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be some sharing or exchange of value . . . beyond the mere flow of funds arising out of a passive investment or a distinct business operation . . . 463 U.S. at 166.

A nondomiciliary corporation's management of investments outside the state has no concrete connection to the conduct of its active business operations within a state. This Court has recognized and reaffirmed this in its unitary decisions.

In order to affirm the decision of the New Jersey Supreme Court, this Court would have to overrule its decisions in *ASARCO* and *Woolworth*. The State has stipu-

lated that while Bendix held its investment in ASARCO, Bendix and ASARCO were unrelated business enterprises each of whose activities had nothing to do with the other; and that none of ASARCO's activities, businesses or income were related to or connected with Bendix's activities, business or income. Stip. ¶¶ 62, 41. Under the holdings of this Court, the investment income received by Bendix, a nondomiciliary corporation, which was derived from the sale of its minority interest in a *nonunitary* corporation cannot be subject to apportionment consistent with Due Process. Therefore, the decision of the New Jersey Supreme Court must be reversed.

ARGUMENT

DUE PROCESS AS APPLIED IN THE DECISIONS OF THIS COURT PREVENTS A NONDOMICILIARY STATE FROM TAXING INCOME RECEIVED FROM INVESTMENTS IN NONUNITARY CORPORATIONS

Under the Due Process Clause principles as developed by this Court in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 354 (1982); *F.W. Woolworth Co. v. Taxation & Revenue Department of the State of New Mexico*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), a State may not tax income received by a nondomiciliary corporation from a passive investment in a nonunitary corporation. The application of these principles to the instant case demands the reversal of the decision of the New Jersey Supreme Court.

In *Mobil, supra*, this Court enunciated the general principle which prohibits a state's taxation of extraterritorial income, stating that "the linchpin of apportionability . . . is the unitary business principle." 445 U.S. at 439. The due process limitations are not contravened "so long as the intrastate and extrastate activities form[] part of a single unitary business." 445 U.S. at 438.

Although in *Mobil* this Court held that the taxpayer was unitary with its foreign subsidiaries so that the dividends received from the subsidiaries could constitutionally be included in apportionable income, this Court cautioned

> We do not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where the corporation does business. *Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State*, due process considerations might well preclude apportionability because there would be no underlying unitary business. 445 U.S. at 441-442 (emphasis added).

In *ASARCO* and *Woolworth*, this Court rejected the states' attempt to apportion and tax dividends, interest and capital gain income received by nondomiciliary parent corporations because the income was derived from "discrete business enterprises", *Woolworth*, 458 U.S. at 372, which in "any business or economic sense" had "nothing to do with the activities" of the parent corporation in the taxing state. *ASARCO*, 458 U.S. at 328.

Moreover, in *ASARCO* and *Woolworth*, this Court noted that the state courts had applied an improper legal standard, focusing on the internal potential economic and business advantages to the parent corporations deemed to arise from parent-subsidiary relationships. In *ASARCO*, this Court rejected the state's position that an internal corporate purpose should define a unitary business or that intangible income should be considered a part of a unitary business if the shares of stock are acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business. However, it is this very "corporate purpose" test which the New Jersey Supreme Court wishes to adopt, even though this Court stated

> [t]his definition of unitary business would destroy the concept. The business of a corporation requires

> that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. *ASARCO*, 458 U.S. at 326 (emphasis and brackets in original).[1]

In *Woolworth*, this Court further stated that the due process limitation would be trivialized

> by holding it satisfied if the income in question "adds to the riches of the corporation . . ." *Wallace v. Hines*, 253 U.S. 66, 70 (1920). Income from whatever source, always is a "business advantage" to a corporation. *Our cases demand more. In particular, they specify that the proper inquiry looks to "the underlying unity or diversity of business enterprise,"* *Mobil, supra*, at 440, *not to whether the nondomiciliary parent derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation.*" 458 U.S. at 363-364 (emphasis added).

Within the different context of applying formulary apportionment to the combined income of worldwide affiliates, in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court reviewed and affirmed the principles articulated in its prior unitary cases, stating

> *[T]he principles we have quoted require that the out-of-State activities of the purported "unitary busi-*

---

[1] This Court also held in *ASARCO* that in considering whether income from investments can be constitutionally included in apportionable income, the same due process analysis is applied to capital gain income that is applied to dividend income. This Court stated that "[c]hanging the form of the income 'works no change in the underlying economic realities of [whether] a unitary business [exists], and accordingly it ought not to affect the apportionability of income the parent receives.' [citation omitted]." 458 U.S. at 330.

> *ness" be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be some sharing or exchange of value* not capable of precise identification or measurement—*beyond the mere flow of funds arising out of a passive investment or a distinct business operation* —which renders formula apportionment a reasonable method of taxation. 463 U.S. at 166 (emphasis added).

In determining whether there was a "sharing or exchange of value" in *Container*, this Court focused on the relationship between Container and its foreign subsidiaries—not upon the relationship between Container's business operations and its investment activities—thus following the focus of this Court's inquiry in *ASARCO* and *Woolworth*.

The due process principle that has been consistently applied by this Court in *Mobil*, *ASARCO*, *Woolworth* and *Container* is that a State may not tax intangible income, including dividends, interest and capital gain income, received by a nondomiciliary corporate taxpayer unless a unitary relationship exists between that taxpayer and the entities in which it invested and from which the investment income was derived. In order to affirm the decision of the New Jersey Supreme Court this Court would have to overrule its prior decisions establishing this due process limitation. The "overruling a precedent of this Court is a matter of no small import, for 'the doctrine of stare decisis is of fundamental importance to the rule of law.' *Welch v. Texas Dept. of Highways and Public Transportation*, 483 U.S. 468, 494 (1987)." *Payne v. Tennessee*, 111 S. Ct. 2597, 2617 (1991) (Scalia, concurring).

Such a departure from precedent requires some "specal justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984), particularly where an established constitutional principle is concerned. *Smith v. Allwright*, 321 U.S. 649,

666 (1944). Additionally, considerations in favor of stare decisis are given the greatest weight in the commercial arena, such as is involved in the instant case. *See, Payne, supra* at 2610. There simply is no special justification for departing from the constitutional standards set forth by this Court in *Mobil, ASARCO, Woolworth*, and *Container*. To do so by adopting New Jersey's "corporate purpose" definition of the unitary business doctrine "would destroy the concept", *ASARCO*, 458 U.S. at 326, as well as destroy the protection intended by the Due Process Clause.

It is not surprising that the states wish to destroy the unitary business concept thereby allowing them to reach the large pool of income resulting from corporate investment activities. Bendix, of course, is not unique in corporate America. Every major corporation has engaged and continues to engage in investment activities that are intended to result in some economic benefit. One could look at the annual reports of every COST member corporation and see language to that effect. However, this type of investment income has no functional connection, in any business or economic sense, with the actual business operations of corporations in nondomiciliary states.

Bluntly stated, the logic of the position taken by the court below suggests that only equity investments by irrational investors—that is, investments made with no knowledge of the issuer, for no apparent business purpose, and for which for all practical purposes are neither monitored nor supervised by the taxpayer—can qualify as "passive" and, therefore, "nonunitary business" investments. Merely framing the issue in terms of the relationship between the taxpayer's business activities and its investment activities would be, without further analysis, effectively dispositive. Absent corporate waste, investment income necessarily "add[s] to the riches" of the corporate investor and, therefore, can be said to be "for

purposes related to or contributing to the [corporation's] business." *ASARCO*, 458 U.S. at 326, 328. Absent mismanagement or a "blind pool", every equity investment of a corporate investor will, to one degree or another, be monitored and supervised and, with respect to the investment itself, will be controlled by the corporate investor. Obviously, the corporate investor enters into such transactions with the intent of earning income. However, "whether the nondomiciliary [corporation] derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation" is not the proper inquiry in determining whether income arose from a unitary business. *Woolworth*, 458 U.S. at 363-364. The unitary test proposed by New Jersey asks no more than whether the "income in question 'adds to the riches of the corporation'". *Id.* Thus, that test is not only contrary to the decisions of this Court, but, in application, is no test at all.

The continued viability of the unitary concept is an issue of major importance to corporate taxpayers. Virtually every major corporation is impacted by the attempts by nondomiciliary states to reach income resulting from passive investments. Taxpayers have continually relied on *ASARCO* and *Woolworth* as those decisions clearly set forth the Due Process limitations on the states' ability to tax income received by nondomiciliary corporations from the investment in unrelated, nonunitary businesses. The decision of the New Jersey Supreme Court flies in the face of these decisions and must be reversed.

CONCLUSION

For the foregoing reasons, the Committee on State Taxation respectfully requests that the decision of the New Jersey Supreme Court be reversed.

Respectfully submitted,

AMY EISENSTADT *
Tax Counsel
JAMES F. BURESH
Chair, Lawyers Coordinating
Subcommittee
COMMITTEE ON STATE TAXATION
122 C Street, N.W., Suite 330
Washington, D.C. 20001
(202) 484-8103

Dated: January 10, 1992

* Counsel of Record